2022 Proxy and Annual Report Season

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Once again, it is time to prepare for the proxy and annual report season. There are many issues to take into consideration when crafting required regulatory disclosures in a manner that conveys effective messaging to the company's investors. Advance planning, careful drafting and multi-faceted review greatly contribute to a successful proxy and annual report season, culminating in a productive annual shareholders' meeting.

This post provides an overview of key issues that companies should consider as they get ready for the upcoming 2022 US proxy and annual report season (2022 Proxy Season), including:

- Virtual Meetings
- Compensation Issues
- Shareholder Proposals
- Environmental, Social and Governance (ESG) Matters
- Human Capital Management
- Board Diversity
- Proxy Voting Advice
- Related Person Transaction Approvals
- Dodd-Frank Rulemaking
- Risk Factors
- Management's Discussion and Analysis
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- ITRA Compliance
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- Director and Officer Questionnaires

Virtual Meetings

COVID-19 travel and gathering restrictions accelerated the growth of virtual shareholders' meetings exponentially, generating a great deal of practical experience and discussions, and to some degree, consensus on key practices. Virtual shareholders' meetings are likely to continue as a regular practice, but there are a variety of forms that virtual meetings may take. Some virtual shareholders' meetings are hybrids, with in-person meetings supplemented by audio and/or video options. Other companies conduct fully virtual meetings, without an in-person component.

One of the first matters companies should consider when planning for their 2022 annual meetings is what format their meetings will take, whether physical, virtual or a combination. The status of the COVID-19 pandemic and the matters presented for a shareholder vote at the annual meeting are factors that may influence this decision. Although companies may delay the final decision until closer to the time they file their proxy statement with the US Securities and Exchange Commission (SEC), if a virtual meeting is being considered, it is helpful to begin making arrangements with third-party service providers well in advance of the SEC filing and annual meeting dates in order to obtain the desired dates, times and services.

If a virtual meeting is being considered, companies should familiarize themselves with applicable laws and governance requirements impacting the ability to hold, and the procedures for conducting, virtual meetings. Specifically, companies should review laws of their jurisdiction of incorporation, as well as the provisions of their charters and bylaws, applicable to convening, postponing, adjourning and reconvening virtual shareholders' meetings. They should determine how to comply with any requirements for making shareholder lists available for inspection in a virtual meeting context. Companies should build time into their annual meeting schedule for dry runs with the virtual systems, even if companies have conducted virtual meetings in the past.

From the company perspective, the virtual meeting format may add efficiency to the flow of meetings. Investors, including proponents of shareholder proposals, may benefit by being able to attend more annual meetings, which increases opportunities to hear from, and engage with, management and directors. Eliminating travel saves expenses for both companies and investors in addition to lowering the environmental impact of shareholders' meetings. However, pre-pandemic, some investors and proxy advisory firms were critical of virtual-only meeting formats and may expect a return to in-person meetings once travel and gathering restrictions are lifted. While hybrid meetings provide flexibility, offering the advantages of both the in-person and virtual formats, they may increase company costs by incurring the traditional in-person meeting costs, such as travel, venue and security, as well as the technology costs of arranging for a virtual meeting platform.

The proxy statement disclosure for a virtual meeting must disclose all necessary information for shareholders to attend and vote their shares, including what information and documentation is needed in order to vote at the meeting and differences in procedures for record shareholders and beneficial shareholders to participate. It is helpful to indicate when the virtual meeting website will be open to log in, ideally at least 15 minutes before the meeting is scheduled to begin, and whether there is a telephone number, email address or chat feature available to report and resolve technical problems.

Question-and-answer sessions can be an important component of an annual meeting, and, as a result, many investors expect the proxy statement to clearly disclose how this will be handled at the meeting, such as whether questions may (or must) be submitted in advance of the meeting or only during the meeting and whether proof of share ownership must be provided when submitting a question. If a company is scheduling the question-and-answer session to occur after the voting is completed and the formal meeting is adjourned in order to minimize the impact of technical glitches on the proposals being voted upon, the company should clearly disclose that fact in its proxy statement. From an investor relations perspective, companies should be sure they have a way to track who submits questions so they have the ability to follow up for further engagement.

Some companies may also choose to post unanswered questions and answers online following the meeting for transparency.

If shareholder proposals are on the agenda for a virtual meeting, companies should coordinate with the proponents in advance of the meeting regarding the logistics for presentation of the proposals at the meeting.

Regulation FD applies in the virtual meeting context, including in situations where a technical difficulty occurs. Therefore, if it happens that some, but not all, participants at a virtual meeting are able to hear some or a portion of the proceedings, the company will need to assess whether material, non-public information was involved, in which case a press release or Form 8-K would be needed to comply with Regulation FD.

Compensation Issues

Say-on-Pay. During the 2021 proxy season, the say-on-pay proposal at most companies once again received majority approval. According to the Semler Brossy 2021 *Say On Pay & Proxy Results* report dated July 29, 2021, only 2.8 percent of the Russell 3000 had a failed say-on-pay vote, which was slightly greater than the 2.2-percent failure rate for the 2020 proxy season. The average vote results of 90.5 percent for Russell 3000 companies and 88.7 percent for the S&P 500 companies, in both cases, were below the average vote results from the prior year.[1] While many say-on-pay failures during the 2021 proxy season were due to misalignment between pay and performance or problematic pay practices, some were likely due to COVID-related compensation practices.

An "Against" recommendation from a proxy advisory firm does not always result in a failed say-on-pay vote, but it will likely cause shareholder support to decline, which may influence the ongoing level and tone of shareholder engagement on compensation matters and director nominees in the coming year, as well as future votes on say-on-pay and director elections. If a company receives a negative proxy voting recommendation from a proxy advisory firm, it often (but not always) prepares additional material in support of its executive compensation program. In order to use such materials, companies must file them with the SEC as definitive additional soliciting material not later than the date first distributed or used to solicit shareholders.

From a planning perspective, companies should remember that a shareholder vote on the frequency of say-on-pay votes needs to be conducted at least once every six years. Therefore, it would be prudent for companies to check when they last conducted a say-when-on-pay vote in order to calendar when they next need to submit a frequency proposal to shareholders.

COVID-19 Adjustments. To the extent that compensation decisions for executive officers made during 2021 were impacted by the COVID-19 pandemic, that should be addressed in the compensation discussion and analysis. If multi-year performance measures were adjusted in light of the pandemic, the adjustments should be explained and the rationale for the changes should be disclosed. Companies should expect proxy advisory firms and investors to pay particular attention to those disclosures.

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[1] *See* https://semlerbrossy.com/wp-content/uploads/2021/07/SBCG-2021-SOP-Report-2021-07-29-_FINAL.pdf

Therefore any such disclosures should be carefully drafted and reviewed by various company representatives, which could include a combination of human resources employees, company lawyers, senior management, compensation committee members and outside advisors.

In October 2020, Institutional Shareholder Services Inc. (ISS) issued a series of frequently asked questions regarding US compensation policies and COVID-19 providing guidance on how it will view certain actions and the types of disclosures in this area that it views as important.[2] To the extent that a company has made, or may be contemplating, COVID-related compensation adjustments for its named executive officers, it should monitor whether proxy advisory firms or investors publish any additional guidance.

Pay Ratio. The pay ratio rule, which requires disclosure of the ratio of the annual total compensation of a company's median employee to that of its chief executive officer, permits a company to identify its median employee only once every three years as long as the company reasonably believes there has been no change in its employee population or compensation arrangements that would significantly change the pay ratio disclosure. The analysis of whether a new determination of the median employee is required is a company-specific matter. For example, if the COVID-19 pandemic impacted employee population and compensation in 2021 in a manner that would significantly change the pay ratio, the company would need to identify a new median employee for 2021, even if the company had identified the median employee for 2019 or 2020. Other events such as significant acquisitions or dispositions could also trigger a need to identify a new median employee for pay ratio disclosure purposes. Companies should assess whether they will need to initiate the process for identifying their median employee this year as early as possible in their preparations for the 2022 Proxy Season. If a company concludes that it is not necessary to identify a new median employee for its 2022 proxy statement, it will need to disclose that it is using the same median employee in its pay ratio calculation and describe briefly the reason for its belief that there have not been any changes requiring a newly determined median employee.

Although companies are not required to provide explanations for their pay ratios, voluntary additional disclosures are generally permitted. To the extent that a company believes its pay ratio changed in 2021 as a result of the global pandemic, including as a result of labor shortages or revised pay structure to attract or retain employees, or is otherwise anomalous, it may want to consider including language referencing that fact in order to provide context for the 2021 pay ratio.

Perquisites. The SEC remains focused on perquisite disclosures and has brought enforcement proceedings in this area over the last few years. For example, in February 2021, the SEC issued a cease and desist order against both a company and its former CEO for failure to disclose perks, including personal use of chartered aircraft and corporate credit cards, that were not disclosed in the proxy statement. More recently, in August 2021, the SEC issued a cease and desist order against a company for failure to disclose as perquisite compensation the cost of flights taken by the company's CEO on a corporate aircraft, as well as charter flights paid for by the company, that were not "integrally and directly related to the CEO's job duties." It is important that

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[2] Available at https://www.issgovernance.com/file/policy/active/americas/US-Preliminary-Compensation-Policies-FAQ-regarding-COVID.pdf

companies have robust disclosure controls and procedures and internal control over financial reporting to be sure all perquisites to named executive officers are identified and disclosed.

Companies that have offered new or modified benefits to executive officers because of the COVID-19 pandemic should consider compliance and disclosure interpretation (C&DI) 219.05, which the staff of the SEC's Division of Corporation Finance (Staff) issued in September 2020 to assess whether those benefits constitute perquisites or personal benefits for purposes of compensation disclosure and determination of the named executive officers.[3] According to C&DI 219.05, an item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties. On the other hand, if an item that confers a direct or indirect benefit has a personal aspect, without regard to whether it may be provided for a business reason or for the company's convenience, it is a perquisite or personal benefit unless it is generally available on a non-discriminatory basis to all employees. C&DI 219.05 recognizes that the COVID-19 pandemic can be considered when assessing whether an item is integrally and directly related to the performance of an executive's duties. This C&DI notes that providing enhanced technology needed to make the executive's home the primary workplace upon imposition of local stay-at-home orders would generally not be a perquisite or personal benefit but indicates that new health-related or personal transportation benefits provided to address new risks arising because of COVID-19 may be perquisites or personal benefits even if the company provided such benefits because of the COVID-19 pandemic, unless they are generally available to all employees.

Shareholder Proposals

Amendments to Rule 14a-8. On September 23, 2020, the SEC adopted amendments to Rule 14a-8 promulgated under the Securities Exchange Act of 1934 (Rule 14a-8).[4] These amendments are effective and currently apply to any shareholder proposal submitted for inclusion in a company's proxy statement for an annual or special meeting to be held on or after January 1, 2022. There is a transition period with respect to the ownership thresholds that will allow shareholders that meet specified conditions to rely on the current $2,000/one-year ownership threshold for proposals submitted for shareholders' meetings being held prior to January 1, 2023.

The amendments to Rule 14a-8 have generated controversy, and there have been some efforts to repeal or modify them. The SEC's spring 2021 regulatory agenda[5] indicates that the Division of Corporation Finance is considering recommending that the SEC propose amendments to Rule 14a-8, with such proposal currently targeted for April 2022. At this time, it appears that the 2020 amendments to Rule 14a-8 will apply to the 2022 Proxy Season. Therefore, it is important to understand what those amendments provide.

Highlights of the 2020 modifications to Rule 14a-8 include amendments to:

[3] Available at https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#219.05
[4] Available at https://www.sec.gov/rules/final/2020/34-89964.pdf
[5] Available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode&showStage=active&agencyCd=3235

- Rule 14a-8(b) to revise the initial submission thresholds to provide a tiered approach that allows for different combinations of the amount of securities held and the duration for which they have been held;
- Rule 14a-8(c) to clarify that a single person may not submit multiple proposals at the same shareholders' meeting, whether the person submits a proposal as a shareholder or as a representative of a shareholder; and
- Rule 14a-8(i)(12) to raise the required level of shareholder support that a proposal must receive in order to be eligible for resubmission at a company's future shareholders' meetings to 5 percent, 15 percent and 25 percent for matters previously voted on once, twice or three or more times, respectively, in the last five years.

Other changes to Rule 14a-8(b) include prohibiting the aggregation of holdings to satisfy ownership thresholds, requiring a shareholder proponent to be available to meet with the company regarding the proposal, and requiring a shareholder who uses a representative to submit a shareholder proposal to provide specified information that indicates the shareholder's knowledge and support of the proposal.

For more information, see our Legal Update, "SEC Amends Shareholder Proposal Rule," dated September 28, 2020.[6]

***Staff Procedural Changes**.* Beginning with the 2020 proxy season, the Staff no longer automatically provides formal no-action letters in response to requests regarding the exclusion of shareholder proposals. When responding to a no-action request to exclude a shareholder proposal, the Staff informs the proponent and the company of its position, indicating whether the Staff concurs, disagrees or declines to state a view with respect to the company's asserted basis for exclusion. The Staff posts this information in a chart of shareholder proposal no-action responses appearing on the SEC's website, indicating, among other details, the regulatory grounds for exclusion of the proposal asserted by the company, the Staff's response to the company's request for exclusion and whether the Staff responded by letter.[7] This chart is searchable by column.

While the Staff's procedural change in responding to no-action requests for exclusion of shareholder proposals pursuant to Rule 14a-8 resulted in the Staff issuing significantly fewer formal no-action letters in the 2020 and 2021 proxy seasons, the text of company no-action requests and proponent responses are available on the SEC's website, with links to the no-action requests, and to the SEC no-action letter, if any, appearing on the chart of SEC responses. By reviewing the arguments for and against exclusion of a proposal, and checking the Staff's response as shown on the chart available on the SEC website, companies and proponents can glean a sense of applicable Staff positions that will be useful in upcoming proxy seasons.

Because the Staff frequently did not reply to Rule 14a-8 no-action requests with formal no-action letters, companies and proponents were not given specific reasons why the Staff agreed with or

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[6] Available at https://www.mayerbrown.com/en/perspectives-events/publications/2020/09/sec-amends-shareholder-proposal-rule

[7] Available at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/shareholder-proposal-no-action-responses.htm

rejected arguments for exclusion. The Staff has not articulated its process for deciding which no-action requests receive a formal no-action letter.

Some of the formal no-action letters from the 2021 proxy season seem designed to distinguish Staff decisions that might otherwise appear inconsistent with no-action positions the Staff took in prior years. Others addressed procedural issues. In addition, the Staff wrote no-action letters emphasizing that whether or not a proposal raises a policy so significant that it would transcend ordinary business is determined on a company-by-company basis, with respect to the facts of that company, and that no policy is universally "significant" in a way that it would always transcend the ordinary business exclusion under Rule 14a-8(i)(7); highlighting fact patterns that were determinative of Staff responses, such as whether a proposal had been substantially implemented under Rule 14a-8(i)(10) or whether a proposal contains a false and misleading statement under Rule 14a-8(i)(3).

Shareholder Proposals Receiving Majority Approval in 2021. While most shareholder proposals do not receive majority support, there were shareholder proposals during the 2021 proxy season that achieved approval from a majority of the shares voting, representing an increase in shareholder proposals passing when compared to the past two years. In addition, there were some shareholder proposals that received significant minority support, which may prompt further engagement between those companies and their shareholders on the matters addressed by such proposals.

Governance matters represented a large portion of the shareholder proposals that received majority approval during the 2021 proxy season. Among the topics of governance proposals receiving majority support from shareholders at multiple companies were the elimination of supermajority voting requirements, increasing the ability of shareholders to act by written consent, the elimination of classified boards of directors, increasing the ability for shareholders to call special meetings, and majority voting for the election of directors. Proposals for the elimination of supermajority voting requirements represented a large proportion of the governance proposals passed, often receiving particularly high levels of shareholder support. In addition, proposals to increase the level of shareholder aggregation allowed for proxy access or to require an independent board chairman, while generally not receiving majority votes in favor of the proposal where such proposals were voted upon, were numerous and frequently received support of over 30 percent in 2021.

Majority support for both social and environmental proposals increased during the 2021 proxy season compared to the prior year. According to the EY Center for Board Matters, 20 percent of environmental and social shareholder proposals that went to a vote for meetings through June 30, 2021, received greater than 50-percent support, up from 12 percent from the prior year and 3 percent five years ago.[8] In addition to environmental proposals that won majority approval, other environmental proposals achieved substantial support, just missing majority support at a few additional companies and garnering support in excess of 30-percent support at many others. Proposals on social issues that garnered strong support included board and workforce diversity

[8] *See* EY Center for Board Matters, "What Boards Should Know About ESG Developments during the 2021 Proxy Season," at https://www.ey.com/en_us/board-matters/esg-developments-in-the-2021-proxy-season

proposals and reports on political spending/lobbying, with a few of each receiving majority support and significant levels of minority support for those that did not pass.

Also, new this year were proposals calling for racial equity audits, and while none of these proposals garnered majority support through June 2021, many of such proposals that were voted on received support over 30 percent despite this being the first year such proposals were voted on.

Possible Topics of Shareholder Proposals for 2022. It is likely that proposals on environmental, social or governance topics similar to those that gained majority or significant support during the 2021 proxy season will be submitted for inclusion in company proxy statements during the 2022 Proxy Season. These may include proposals relating to board diversity, workforce diversity and EE0-1 reporting, climate change, sustainability, political spending or governance topics affecting shareholder rights, such as written consent, special meetings or proxy access. In addition, some of the relatively new proposals (such as proposals requesting racial equity audits or say-on-climate) or variations on 2021 shareholder proposal topics (such as requesting an annual report on diversity and inclusion efforts) may be the subject of shareholder proposals for the 2022 Proxy Season.

Environmental, Social and Governance (ESG) Matters

The momentum for ESG has been growing dramatically in recent years, and, as a result, there has been increasing disclosure of ESG topics in proxy statements and annual reports. Many large institutional investors have published proxy voting and engagement guidelines prioritizing ESG issues. And, there are several third-party frameworks for ESG disclosure that have been growing in influence, such as the Sustainability Accounting Standards Board (SASB) and Task Force on Climate-Related Financial Disclosures (TCFD) frameworks. BlackRock and Vanguard have expressly endorsed SASB and TCFD in their own proxy voting guidelines. State Street has developed its own R-Factor score to evaluate a company's ESG based on the SASB framework. There are also a number of organizations separately rating companies based on ESG factors, including Bloomberg, ISS, CDP and MSCI.

In addition to the climate change and other environmental and sustainability concerns, social issues have risen in prominence as important ESG initiatives. The heightened focus on racial and social justice has raised awareness of issues such as workforce diversity and discrimination and efforts that companies could be making to address such societal problems. The impact of COVID-19 has highlighted issues such as employee health and safety and remote working issues. Required disclosures relating to human capital management as part of the business section of annual reports and registration statements, and the priority that institutional investors are giving to human capital management as an engagement matter, has also contributed to interest in the social component of ESG.

ESG disclosure is now a publicized priority for the SEC. The SEC's spring regulatory agenda indicates that proposed rule amendments are expected in the fourth quarter of 2021. While the spring agenda is very ambitious regarding fall 2021 rulemaking and dates on the SEC's regulatory agenda often slip, the SEC, and especially SEC Chair Gary Gensler, have been very vocal in the expectation of a mandatory climate change risk disclosure proposal by the end of 2021. Although it is unlikely that a final rule will be in place in time for the 2022 Proxy Season, a climate change proposal will undoubtedly influence the drafting and evaluation of ESG disclosures.

Misleading ESG disclosures can give rise to SEC enforcement proceedings and hefty monetary penalties. Many states are also focused on ESG disclosures. A comment letter to the SEC signed by a dozen state attorneys general observed:

"States have a strong interest in protecting their investor populations and ensuring that retail investors have the information they want and need when making their investment decisions, as reflected in enforcement actions under state law to ensure that publicly traded companies adequately disclose risks associated with climate change." [9]

Even without the impetus of a mandatory climate change disclosure and the potential of federal or state enforcement proceedings, increased ESG awareness among investors and other constituencies, as well as companies themselves, has prompted a growing number of companies to include sustainability initiatives in distinct sections of their proxy statements in addition to disclosures in annual reports. The approach of adding voluntary ESG disclosure in the proxy statement may provide an opportunity for companies to control their message and provide a basis to direct shareholder engagement in this area.

When preparing ESG disclosure for the proxy statement, companies should be cognizant of the securities laws and other legal ramifications of such disclosure. For example, from a liability perspective, it may be prudent to describe corporate ESG initiatives in aspirational terms rather than as commitments to achieve specific results. Companies may need to expand their disclosure controls and procedures, and possibly their internal control procedures, to take ESG disclosures into account. The team involved in drafting and approving ESG disclosure should develop a process to fact-check disclosures. Board oversight and review of ESG disclosure may help to confirm alignment with company initiatives. It is important that public companies draft ESG disclosure in a manner that is not susceptible to a characterization that it is inaccurate or misleading. It may be useful for companies to include disclaimers in their ESG disclosure.

Human Capital Management

Recent amendments to Regulation S-K explicitly require, to the extent material, a discussion of human capital resources, including the number of employees, as well as any human capital measures or objectives that the company focuses on in managing its business in the business section of an annual report on Form 10-K. This requirement, set forth in Item 101(c) of Regulation S-K, is principles-based, although it specifies the types of information that may be material to certain companies. For example, the regulation identifies measures or objectives addressing the development, attraction and retention of personnel as types of disclosures that may be appropriate to discuss, depending on the nature of a company's business and workforce.

There was a wide variation in how companies implemented the human capital disclosure requirement in annual reports on Form 10-K filed in 2021, including with respect to the amount of detail given and the human capital measures discussed. Some companies also included human

[9] Available at https://oag.ca.gov/system/files/attachments/press-docs/Final%20SEC%20Climate%20Disclosure%20Comment%20Letter%20-%20061421.pdf

capital disclosure in their proxy statements. The impact of the COVID-19 pandemic was a common theme for human capital disclosures made during 2021, covering matters such as workers' health and safety and remote working. In upcoming human capital disclosures, some companies may determine it is appropriate to discuss vaccine policies and other return to the office or hybrid work policies. Diversity, equity and inclusion with respect to the workplace was a frequent human capital management topic of discussion in annual reports filed in 2021, which sometimes was addressed in general terms while other examples contained specific quantitative metrics on various characteristics, such as race, ethnicity, gender and gender identity, sexual orientation, disability and age. In addition to the number of employees, some companies provided a breakdown of employees based on geographic location or type of position. Other human capital disclosures during 2021 discussed employee recruitment, turnover, retention, training and engagement, as well as labor relations. In preparing upcoming annual reports, companies should review a spectrum of precedents to assess whether they should expand or supplement the approach they used in 2021.

The SEC's spring regulatory agenda indicates that the SEC is targeting the fall of 2021 for proposed amendments to enhance human capital discussions. Although it is unlikely that any final amendment would be adopted in time to require compliance in annual reports for the year ended December 31, 2021, companies should monitor that potential rulemaking to consider if it makes sense to adopt any aspects of the proposal voluntarily in their next annual report.

Companies should also recognize that many institutional investors have made human capital management disclosure and engagement a priority. As a result, companies may want to take into account the perspectives of their shareholders, in addition to SEC disclosure requirements. And, because human capital management is important to employee relations, companies should consider the vantage points of various employees when drafting human capital management disclosure.

Human capital management has become a very prominent disclosure topic. Companies should begin preparing this section of their annual report, and any corresponding proxy statement disclosure, well in advance of the filing deadline to allow review by multiple departments within their companies, outside advisors, senior management and directors.

Board Diversity

Proxy statement disclosure of specific details of board diversity has been expanding over the past few years. Some large investors have been advocating for increased board diversity disclosures, including in the form of a matrix. The EY Center for Board Governance found that 86 percent of Fortune 100 companies voluntarily disclosed the board's racial/ethnic diversity in 2021.[10] Board diversity shareholder proposals garnered strong support in 2021 and, as a result, shareholders and proxy advisory firms will be expecting companies to be responsive to such requests.

In August 2021, the SEC approved Nasdaq's board diversity rule, requiring Nasdaq-listed companies to have, or to explain why they do not have, at least two diverse directors, including (1) at least one director who self-identifies as female (regardless of gender designation at birth)

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[10] *See* EY Center for Board Matters, "What Boards Should Know About ESG Developments during the 2021 Proxy Season," at https://www.ey.com/en_us/board-matters/esg-developments-in-the-2021-proxy-season

and (2) at least one director who self-identifies as either an "Underrepresented Minority," as defined in the Nasdaq rule, or as LGBTQ+ and to annually disclose directors' self-identified gender, race and ethnicity in a standardized board diversity matrix.[11] Nasdaq has provided a transition period for its diversity objective but is requiring board diversity matrix disclosure by the later of (1) August 8, 2022, or (2) the date the company files its proxy statement or its information statement for its annual meeting of shareholders (or, if it does not file a proxy or information statement, the date it files its Form 10-K or 20-F) during the 2022 calendar year.

For more information, see our Legal Update, "SEC Approves Nasdaq Board Diversity Rule," dated August 10, 2021.[12]

Even companies that are not listed on Nasdaq should pay attention to Nasdaq's new board diversity policy because additional board diversity initiatives may be forthcoming. There are already other drivers of board diversity, such as California's statutory mandates for companies with principal executive offices in the state, voting policies established by proxy advisory firms, voting policies and engagement priorities of large institutional investors and public perception. At least one underwriter has established minimum board diversity requirements for the clients it assists with initial public offerings. And, a number of states are considering board diversity legislation. The SEC's spring 2021 regulatory agenda targets the fall of 2021 for proposed rule amendments to enhance company disclosures about the diversity of board members and nominees. While that timing suggests that amendments to the SEC's board diversity requirements will not be in effect for 2022 proxy statements, once it is issued the proposal may influence what investors expect and possibly investor voting guidelines and proxy voting advice recommendations. Taken together, all of these actions may prompt companies to consider enhancing board diversity disclosure in their 2022 proxy statements.

Companies should remember that changes to their nominating committee's process for identifying and evaluating nominees for director may require revised disclosure in a Form 10-K or proxy statement in response to Item 407(c)(vi) of Regulation S-K. Additionally, according to C&DIs 116.11 and 133.13, if a board or nominating committee has considered self-identified diversity characteristics such as the race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background of an individual in determining whether to recommend a person for board membership, and the individual has consented to the company's disclosure of those characteristics, the Staff expects that the company's proxy statement will include, but not necessarily be limited to, identification of those characteristics and how they were considered. Similarly, in such a circumstance, the Staff expects the proxy statement's description of company diversity policies to discuss how the company considers the self-identified diversity attributes of nominees, as well as any other qualifications its diversity policy takes into account, such as diverse work experiences, military service, or socio-economic or demographic characteristics.

For more information, see our Legal Update, "Disclosure of Board Self-Identified Diversity Characteristics," dated February 11, 2019.[13]

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[11] *See* https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf

[12] Available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2021/08/sec-approves-nasdaq-board-diversity-rule.pdf

[13] Available at https://www.mayerbrown.com/en/perspectives-events/publications/2019/02/disclosure-of-board-selfidentified-diversity-chara

Proxy Voting Advice

In July 2020, the SEC adopted amendments to its proxy solicitation rules in order to enhance the transparency, accuracy and completeness of the information that proxy advisory firms, such as ISS and Glass, Lewis & Co., provide to investors and others who vote on behalf of investors. These amendments codified the SEC's prior guidance and interpretation that voting advice produced by proxy advisors generally constitutes a solicitation under the proxy rules and that the failure to disclose material information regarding proxy voting advice could cause such advice to be misleading in violation of the proxy rules. These amendments became effective on November 2, 2020. However, as a transition period, proxy advisors were given until December 1, 2021, to comply with new conditions to exemptions from the proxy rules' information and filing requirements that proxy advisors typically have relied upon.

For more information, see our Legal Update, "SEC Adopts Proxy Voting Advice Rule Amendments," dated July 28, 2020.[14]

The SEC is now revisiting the proxy voting advice amendments. In June 2021, SEC Chair Gensler issued a public statement directing the staff "to consider whether to recommend further regulatory action regarding proxy voting advice."[15] In particular, Chair Gensler instructed the staff to consider, among other matters, whether to recommend that the SEC revisit (1) the definition of solicitation as encompassing proxy voting advice, including related SEC guidance, and (2) the conditions on exemptions from the information and filing requirements that were contained in the proxy voting advice amendments.

In light of the direction from Chair Gensler, the SEC's Division of Corporation Finance issued a public statement indicating that it will not recommend enforcement action based on the amendments or the related guidance during the period in which the SEC is considering further regulatory action with respect to proxy voting advice.[16] In addition, if the SEC retains the exemption conditions contained in the amendments that currently have a December 1, 2021, compliance date, the Division of Corporation Finance will not recommend any enforcement action based on those conditions for a "reasonable period of time" after any resumption by ISS of its litigation challenging the amendments and guidance, which litigation is currently being held in abeyance.

Related Person Transaction Approvals

Item 404(b) of Regulation S-K requires disclosure of the approval policies for related person transactions that are reportable pursuant to Item 404(a) of Regulation S-K. In April 2021, the New York Stock Exchange (NYSE) amended Section 314 of its Listed Company Manual to require that the audit committee or another independent body of the board of directors conduct a reasonable *prior* review and oversight of all related party transactions. For the purposes of the amended rule, the term "related party transaction" expressly refers to transactions required to be

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[14] Available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/07/sec-adopts-proxy-voting-advice-rule-amendments.pdf
[15] Available at https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01
[16] Available at https://www.sec.gov/news/public-statement/corp-fin-proxy-rules-2021-06-01

disclosed pursuant to Item 404 of Regulation S-K, or, in the case of foreign private issuers, to transactions required to be disclosed pursuant to Form 20-F, Item 7.B.

Initially amended Section 314 required the determination of related party transactions subject to review and oversight to be made without applying the transaction value threshold of Item 404 of Regulation S-K or the materiality threshold of Item 7.B of Form 20-F. However, in August 2021, the NYSE reversed itself and further amended Item 314 of its Listed Company Manual so that that the review and approval requirement of that rule is applicable only to transactions that are required to be disclosed, *taking into account* the transaction value and materiality thresholds set forth in Item 404 of Regulation S-K or Item 7.B of Form 20-F, respectively, as applicable.

NYSE companies should be sure that their approval processes for related person transactions have been updated to satisfy the new NYSE requirements, which are already in effect, and should update their proxy statements to reflect any revised approval procedures.

Dodd-Frank Rulemaking

The Dodd-Frank Wall Street Reform and Consumer Protection Act directed the SEC to adopt rules relating to pay versus performance disclosure and clawback listing standards that have been stalled for years at the proposal stage, without the adoption of final rules. However, with the change in administration, the SEC has indicated that it will be moving forward with these two rulemakings.

Pay Versus Performance Disclosure. In 2015, the SEC proposed a “pay versus performance” rule to require companies to disclose in a clear manner the relationship between executive compensation actually paid and the financial performance of the company, with performance measured both by company total shareholder return (TSR) and peer group TSR. This proposal would require companies to add a new pay versus performance table to their proxy statements to separately provide annual compensation information for the chief executive officer for each of the past five fiscal years. In addition, the table would have to provide average annual compensation for the named executive officers (other than the chief executive officer) identified in the summary compensation table for those years. A clear description of the relationship between pay and performance would have been required to accompany the proposed new table. According to its rulemaking agenda, the SEC is targeting the adoption of a final pay versus performance rule for the spring of 2022. Based on this schedule, the final pay versus performance rule will not likely affect the 2022 Proxy Season for calendar-year companies.

Clawbacks. In 2015, the SEC proposed a new rule directing national securities exchanges and associations to establish listing standards that prohibit the listing of any security of a company that does not adopt and implement a written policy requiring the recovery, or “clawback,” of certain incentive-based executive compensation payments. As proposed, the recovery would equal the amount of incentive compensation payments that are later shown to have been paid in error, based on an accounting restatement that is necessary to correct a material error of a financial reporting requirement. According to its rulemaking agenda, the SEC plans to re-propose its clawback rule in the spring of 2022 before moving to a final rule, at which point the stock exchanges would need to develop amended listing standards for submission to the SEC for approval.

Risk Factors

Risk factor disclosure is an important feature of an annual report. It must focus on the material factors that make an investment in a company speculative or risky, tailored to the specific reporting company. The disclosure must be organized under relevant headings. If a company chooses to disclose a risk that could apply to other companies or securities offerings without explaining why the identified risk is specifically relevant to investors in the company's securities, the rule requires such generic disclosure to be placed at the end of the risk factor section under the caption "General Risk Factors." If the risk factor discussion exceeds 15 pages, a risk factor summary of not more than two pages is needed.

Cybersecurity and data privacy continue to be risks that many companies need to address in their annual reports. The SEC's regulatory agenda targets the fall of 2021 for proposed amendments to enhance issuer disclosures regarding cybersecurity risk governance. Companies should monitor this expected rulemaking to determine the extent to which it may be appropriate for them to incorporate some of the proposed principles before any final rule is adopted.

In the process of updating their risk factor disclosures, companies should also carefully consider whether they should add or supplement risk factor disclosure on how they are affected by climate change, another area of SEC focus. And, COVID-19 risks may have evolved over time requiring modification, especially as a result of vaccines, vaccine hesitancy, variants and break-through infections.

Other types of risks that may be relevant for annual reports are risks relating to the transition away from LIBOR, intellectual property risks, information technology risks and risks of conducting substantial business in emerging markets. Shortages of supplies or labor or shipping delays may need to be disclosed as a risk. If a company has recent acquisitions, it may be necessary to add or revise integration disclosure. In addition there may be risks that are unique to an individual company. Because risks for a company may change from year to year, and because material risks can arise from various aspects of a company's business, it is important from a disclosure control perspective that the full set of risk factors contained in an annual report be reviewed by the appropriate departments within the company to determine whether any new risks need to be added or any existing risk factor disclosure needs to be revised.

While taking a fresh look at risk factor disclosures each year is an important exercise for the entire risk factor section, companies should be particularly sensitive to situations where they previously described a risk in hypothetical terms and subsequently an actual event of that nature occurred. In these circumstances an update to the risk factor may be needed to avoid securities law liability for misleading risk factors. This is becoming an issue in the cybersecurity area, both for SEC and private litigation, where a prior risk factor discussed the potential of data breach or ransomware attack and thereafter the company suffered a cyber-event. For example, in a 2021 SEC enforcement proceeding that resulted in a cease and desist order and a $1 million penalty, the SEC order observed that the company's risk factor disclosure implied that the company faced the hypothetical risk that a "data privacy incident…could result in a major data privacy or confidentiality breach" but did not disclose that it had in fact already experienced such a data breach.[17]

Management's Discussion and Analysis

The SEC's 2020 amendments to the requirements for management's discussion and analysis of financial condition and results of operations (MD&A) set forth in Item 303 of Regulation S-K became effective February 10, 2021. Companies were given until their first fiscal year ending on or after August 9, 2021 to comply with the amended MD&A rules. Companies were permitted to comply with the amendments early, which some companies did. Most companies will need to prepare their MD&A in compliance with the amended MD&A requirements for the 2022 Proxy Season. Therefore, it may be prudent to begin the process of drafting the MD&A earlier this year, especially if this will be the first annual report prepared in compliance with the amendments.

The MD&A amendments added new requirements to Item 303, deleted some requirements, simplified some instructions to Item 303 and revamped other requirements. The more significant changes to Item 303 of Regulation S-K impacting MD&A in annual reports on Form 10-K include:

- addition of a new paragraph (a) to Item 303 to clarify the objective of MD&A;
- revision of the capital resource section to require disclosure of material cash requirements, including commitments for capital expenditures, the anticipated source of funds needed to satisfy these cash requirements and the general purpose of the cash requirements;
- revision of the results of operations section to:
    - require disclosure of known events that are reasonably likely to cause a material change in the relationship between costs and revenues,
    - require disclosure reasons underlying material changes in net sales or revenues, and
    - eliminate specific disclosure with respect to the impact of inflation and changing prices, although companies are required to discuss these matters if they are part of a known trend or uncertainty that has had, or is reasonably likely to have, a material impact on net sales or revenue;
- replacement of the prior off-balance sheet arrangement disclosure with an instruction requiring companies to discuss commitments and obligations arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on their financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources;
- elimination of tabular disclosure of contractual obligations, but addition of a specific requirement to disclose material cash requirements from known contractual and other obligations as part of a liquidity and capital resources discussion; and
- codification of existing guidance requiring disclosure of:
    - underlying reasons for material changes in line items in quantitative and qualitative terms, and

[17] *See* https://www.sec.gov/litigation/admin/2021/33-10963.pdf

- critical accounting estimates.

For quarterly periods, the MD&A amendments allow companies to compare their most recently completed quarter to either the corresponding quarter of the prior year or to the immediately preceding quarter. As part of the same rulemaking, the SEC also amended Item 302 of Regulation S-K (Supplementary Financial Information) by replacing the requirement to provide two years of tabular selected quarterly financial data with a principles-based requirement and eliminated Item 301 of Regulation S-K (Selected Financial Data).

For more information, see our Legal Update, "SEC Adopts Significant Changes to MD&A and Related Disclosures," dated November 24, 2020.[18]

Holding Foreign Companies Accountable Act Disclosure

In order to implement the disclosure requirements of the Holding Foreign Companies Accountable Act, the SEC adopted interim final rules that added a new Item 9C to Form 10-K. The new disclosure item applies to foreign issuers that have been identified by the SEC as having retained, for the preparation of the audit report on their financial statements, an accounting firm that the Public Company Accounting Oversight Board has determined it is unable to inspect or investigate completely because of a position taken by an authority in the foreign jurisdiction in which the accounting firm's office or branch is located. Those issuers must also provide disclosure regarding their ownership by governmental entities in the foreign jurisdiction in which they are incorporated as well as specified connections to the Chinese Communist Party.

For more information, see our Legal Update, "SEC Adopts Interim Final Rules to Implement the Holding Foreign Companies Accountable Act," dated March 26, 2021.[19]

ITRA Compliance

The Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA) continues to require Form 10-K and Form 10-Q disclosure if, during the period covered by the report, the company or any affiliate knowingly engaged in certain sanctionable activities, *regardless of whether those actions violate US law and without any materiality threshold*. If a company is required to report this activity in its annual or quarterly report, it must also separately file with the SEC, at the same time it files its annual or quarterly report, a notice that such disclosure is contained in the report.

The ITRA disclosure requirement is statutory. There is no corresponding SEC regulation and the ITRA disclosure requirement is not referenced in the instructions for SEC annual or quarterly report forms. Companies should evaluate ITRA compliance as part of their annual and quarterly reporting process.

[18] Available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/11/sec-adopts-significant-changes-to-md.pdf

[19] Available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2021/03/legal-alert–sec-adopts-interim-final-rules-to-implement-the-hfca-act.pdf

Although ITRA disclosure requirements are typically framed in terms of Iran, some of the statutory provisions are broader, such as Section 13(r)(1)(d) of the Exchange Act that requires reporting if the issuer or an affiliate:

> (D) knowingly conducted any transaction or dealing with
>
> . . .
>
> (ii) any person the property and interests in property of which are blocked pursuant to Executive Order No. 13382 (70 Fed. Reg. 38567; relating to blocking of property of weapons of mass destruction proliferators and their supporters).

In March 2021, a number of Russian entities and individuals became designates as subject to Executive Order No. 13382, including the Federal Security Service of the Russian Federation (FSB). Companies with operations in Russia should consider whether they need to make any modifications to their disclosure controls and procedures with respect to ITRA to assess whether these Russian measures give rise to required disclosure and notice requirements.

Electronic Signatures on SEC Filings

Rule 302 of Regulation S-T now allows for manual signatures or electronic signatures on EDGAR filings provided certain procedures are followed. Companies planning to use electronic signatures on their annual report or other filings with the SEC should be sure they implement procedures to comply with the SEC's electronic signature requirements sufficiently in advance of the filing date to the extent they have not already done so.

Before a signatory initially uses an electronic signature to sign an authentication document, amended Rule 302(b) requires the signatory to *manually* sign a document attesting that the signatory agrees that the use of an electronic signature in any authentication document signed thereafter constitutes the legal equivalent of such individual's manual signature for purposes of authenticating the signature to any filing for which it is provided (an initial electronic signature authentication document). The electronic filer must retain this manually signed document for as long as the signatory may use an electronic signature to sign an authentication document and for a minimum period of seven years after the most recent electronically signed authentication document. Upon request, the electronic filer must furnish a copy of such manually signed document to the SEC or its staff.

The required process to be followed for electronic signatures on documents filed with the SEC via EDGAR is set forth in the EDGAR Filer Manual. In particular, when a signatory signs an authentication document using an electronic signature, the signing process must at a minimum:

- require the signatory to present a physical, logical or digital credential that authenticates the signatory's individual identity;
- reasonably provide for non-repudiation of the signature;
- provide that the signature be attached, affixed or otherwise logically associated with the signature page or document being signed; and
- include a timestamp to record the date and time of the signature.

Electronic filers must retain the authentication document for a period of five years and furnish a copy of it upon request to the SEC or its staff.

For more information, see our Legal Update, "SEC Adopts Rules to Facilitate Electronic Submission of Documents," dated November 19, 2020.[20]

Director and Officer Questionnaires

To the extent that companies determine to include self-identified diversity characteristics in their proxy statements, they may want to develop or expand questions for their questionnaires to elicit such information or otherwise develop a mechanism to gather it. The questionnaire or other procedure should include obtaining the director's or nominee's consent to disclosure. For Nasdaq-listed companies in particular, it would be useful to gather the director's self-identified diversity characteristics in advance of the upcoming deadline for the new Nasdaq board diversity matrix disclosure. In addition, if companies need to provide diversity data on directors and officers for other purposes, such as a state law requirement, adding one or more questions to the director and officer questionnaire process may be the best vehicle for gathering that information.

[20] Available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/11/sec-adopts-rules-to-facilitate-electronic-submission-of-documents.pdf